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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 1207

ELMER J. BENES and FRANCES M. BENES,
E. J. BENES & COMPANY, INC.,

Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners hereby petition this Honorable Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit affirming that part of the judgment of the Tax Court of the United States in which it was held,

1. That petitioner Elmer Benes " * * * realized taxable income in each of the years 1947 through 1950, to the extent that in each such year the Benes Company (of which he was president and owner of 500 of its 503 shares of stock outstanding) paid or incurred expenses in the erection of a residential home which Benes intended from the beginning should be the personal, private residence of him and his family and for which he had no intention of making payment to the corporation at any time, while the resi-

dence was being constructed or when construction was completed" (App. 68a).

2. That the deficiency in tax on the original return filed by petitioner Benes Company for each of its fiscal years ended May 31, 1947 through 1950, and the deficiency in tax of the individual petitioners Elmer and Frances for each of the calendar years 1947 through 1950 are due to fraud with intent to evade tax within the meaning of section 293(b). Accordingly, respondent's impositions of additions to tax for fraud under said section are approved (App. 69a).

3. That all of the original returns of the corporate petitioner and all of the returns of the individual petitioners are false or fraudulent with intent to evade tax, within the meaning of section 276(a); and accordingly, assessment and collection of deficiencies and additions to tax of the corporate petitioner for its fiscal year ended May 31, 1947, and of the individual petitioners for their calendar year 1947, are not barred by limitations (App. 69a).

4. That petitioners Elmer and Frances Benes constructively received salary from the Benes Company, in addition to the salary payments actually received by them in 1947 (App. 69a).

5. That assessment and collection of the deficiency and additions to tax for 1947 in the case of the individual petitioners are also precluded from being barred by limitation, by reason of the fact that said petitioners omitted from income on their 1947 return an amount in excess of 25 per cent of the gross income stated in such return. In such circumstance, a 5 year (rather than a 3 year) period is allowed for the assessment and collection, section 275(c);

and the respondent's notice of deficiency to said individual petitioners was mailed within 5 years after their 1947 return was filed (App. 70a).

Opinions Below

The decision of the Court of Appeals for the Sixth Circuit is reproduced in Appendix A to this petition at 1a,* and is officially reported at —— F. 2d —— (6th 1966). The opinion of the Tax Court of the United States is reported at 42 TC 358 and appears at pages 68a-116a of the record appendix printed for the appeal to the Sixth Circuit, nine copies of which appendix will be filed with this petition. Supreme Court Rules 21(4), 23.

Jurisdiction

Jurisdiction is conferred on the Supreme Court under Section 1254(1), Title 28, United States Code, which provides that:

> "Cases in the Court of Appeals may be reviewed by the Supreme Court by the following methods:
>
> (1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;"

The judgment of the Court of Appeals for the Sixth Circuit was entered on January 10, 1966. Their decision affirming the judgment of the Tax Court of the United States contained no independent opinion by the Court of

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* References to the record appendix will be designated herein "App. ——".

Appeals for the Sixth Circuit, but simply pointed to the opinion of Judge Pierce of the Tax Court of the United States as the basis for its decision.

Questions Presented

1. Was the judgment of the Tax Court of the United States (affirmed by the Court of Appeals for the Sixth Circuit) based on a consideration of the totality of the evidence in the record or does the opinion of the Tax Court of the United States reflect a careful selection and equally careful discard of evidence for the purpose of justifying a preconceived notion of petitioners' guilt.

2. Was the petitioner's (Elmer Benes') right to a fair trial guaranteed by the due process clause of the Fifth Amendment violated by the failure of the Tax Court to mention by so much as a word (a) facts and circumstances that supported petitioner's contentions, (b) facts and circumstances that seriously affected the credibility of witnesses, and by inferences and conclusions drawn by the Tax Court which do not square with the well-springs of human conduct.

3. Did the individual petitioners *constructively receive* amounts as salary from petitioner corporation in 1947 in addition to amounts actually received and reported by them as corporate salary for such year.

Constitutional Provisions Involved

United States Constitution, Fifth Amendment

> "No person shall be * * * deprived of life, liberty, or property, without due process of law; * * * *"

Statutes Involved

Internal Revenue Code of 1939:

Section 275 (26 USC 1952 ed., §275)
Section 276 (26 USC 1952 ed., §276)
Section 293 (26 USC 1952 ed., §293)
Section 1112 (26 USC 1952 ed., §1112)

Internal Revenue Code of 1954:

Section 7482 (26 USC 1952 ed., §1112)

Rules Involved

Federal Rules of Civil Procedure, Rule 52

Treasury Regulations 111, Sec. 29.42-2

Treasury Regulations 111, Sec. 29.42-4

Statement of the Case

With respect to the individuals, the respondent's position is:

(a) That there was an ab-initio intent on the part of the individuals to acquire the house constructed by the corporate petitioner, *coupled with*

(b) an ab-initio and continuing intent not to pay for the house either during construction or when construction was completed.

(c) That Elmer Benes designed a mechanical bookkeeping system for the purpose of concealing the fact that construction costs were deducted by the corporate petitioner as the costs were incurred.

The petitioners do not disagree that the rationale of *Davis* v. *United States* (C.A. 6), 226 F. 2d 331 is proper in a case where the facts are such as to bring the case within it. The petitioners contend however that the facts of the instant case are not such as to bring the instant case within it.

Petitioners contend that *anything short of* an ab-initio intent to acquire PLUS an ab-initio intent not to pay is fatal to the respondent's case.

If there was no intent to acquire from the beginning, then Elmer Benes could hardly be expected to intend to pay from the beginning.

If an intent to acquire arose later—particularly if it arose when the house neared completion—then payment is persuasive evidence of an intent to pay when the intent to acquire arose. The facts are that Elmer Benes agreed to pay for the house before Revenue Agent Sullivan set foot in his office and that he had paid approximately $70,000.00 to the corporation prior to the time Revenue Agent Lewitt set foot in his office and that subsequently he paid the entire cost of the house to the corporation (App. 34a; App. 93a) (App. 51a).

If there was no intent to acquire from the beginning, then the accusation of concealment for the purpose of hiding an intent to acquire from the beginning makes no sense.

If there was no intent to acquire from the beginning, then the intent at the beginning had to be an intent to sell to an outsider because the corporation as a corporation had no use for the house as a house.

If the initial intent was to sell to an outsider then the deduction of costs as incurred by the corporate petitioner

was consistent with Elmer Benes' practice for all the years he had been in the construction business. Furthermore, a deduction of costs as incurred by a building contractor is a method of accounting that has the blessing of the Commissioner of Internal Revenue. Treasury Regulations 111, Sec. 29.42-4 provides in effect that a building contractor whose construction jobs take more than one year to complete may report costs and income by what is known as the percentage of completion method. Under this method, costs are deductible *when incurred without reference to the time of billing.* Billings, based on the percentage of completion, could not be made in this case since there was no known customer at the start of construction or during construction. It may be argued that because there was no known customer and therefore no possibility of billing, that the percentage of completion method of accounting was not available with respect to this construction; that because the percentage of completion method was not available, Benes should have *changed* his accustomed method of accounting.

Even if this argument is accepted, what crime did Benes commit? His crime consisted in doing what came naturally; in doing what he had done for all past years. His crime consisted of being consistent in deducting costs as incurred. It is respectfully submitted that under the circumstances the deduction of costs as incurred does not warrant even the imposition of a negligence penalty, let alone a fraud penalty.

The Tax Court's failure to comment on many salient, material and relevant facts in the record reflects a bias.

The Tax Court concluded that Elmer Benes had expressed a desire to live in the Village of Hunting Valley as early as 1945 (App. 102a).

While the Tax Court neglects to mention Seidehammel's name, it is clear that its conclusion is based solely on Seidehammel's testimony in spite of Benes' denial.

The record establishes that James Seidehammel lied in another area of his testimony and that his lie was designed to hurt Benes' cause (App. 37a to 39a incl.). Nowhere in its opinion does the Tax Court indicate that it noted the lie or that it had the slightest effect on its judgment with respect to Seidehammel's credibility. The statement which the Tax Court accepts as gospel was allegedly made when Seidehammel met Benes for the first time in his life; while a doctor was examining Benes' seriously ill daughter. Nowhere in its opinion does the Tax Court indicate that it considered the possibility that this testimony too might be a fabrication designed to hurt Benes; that a discussion of real estate deals under the particular circumstances was highly unlikely; that Seidehammel might not be Benes' friend and that Seidehammel's failure to recall some trouble with Benes about a ladder and scaffolding might be convenient.

The facts in the record establish that Revenue Agent Sullivan lied when Benes' freedom was at stake in the criminal case (App. 57a, 58a, 63a). There is no comment in the record by the Tax Court. Instead, when there is a conflict between Sullivan's testimony and Benes' testimony in another area, the Tax Court accepts Sullivan's testimony as gospel and pins "a badge of fraud" on Benes (App. 113a).

Sullivan was a key witness in the criminal case. Respondent refused to call him in this case. There was no comment and no indication that the Tax Court appreciated the possibility that the failure to call Sullivan indicated a knowledge that Sullivan lied in the criminal case and in-

dicated a desire to keep this fact out of the record. The Tax Court noted that Sullivan had testified that he had written a "no-change" report, but failed to appreciate the fact that this testimony established conclusively that he lied when Benes' freedom was at stake.

Neither Revenue Agent Sullivan nor Revenue Agent Nissenson had requested or examined a single solitary invoice (App. 33a; App. 55a). There was no comment and no appreciation by the Tax Court that the failure to request or examine a single invoice is clear evidence that no examination worthy of the name was made and that the failure to see the allocation of costs was the result of a failure to make even a cursory examination and not the result of clever concealment. Instead, the Tax Court points to the fact that both Sullivan and Nissenson were certified public accountants and concludes that therefore the failure to see the allocation of house costs was the result of clever concealment. There was no appreciation of the fact that a label cannot cure a failure to make an examination.

During the cross-examination of Ben Lewitt it was demonstrated that a reasonably prudent revenue agent conducting an ordinary examination would see the allocation of costs in a matter of ten minutes (App. 53a, 54a). It was also clearly established that all invoices pertaining to the house clearly identified the house and were not "doctored" or changed and that the same was true of payroll sheets (App. 34a). There was no comment by the Tax Court. The Tax Court points to the fact that there was no separate ledger sheet for the house and concludes that this fact is evidence of concealment. The Tax Court fails to note that Mary Mirenda testified that she alone was responsible for the mechanical recording and that

Benes had absolutely nothing to do with and no knowledge of the mechanical method of recording.

Benes visited McQuilkin on April 15, 1951 before any revenue agent called (App. 34a). Benes asked McQuilkin how much he had to pay the corporation for the house cost, less than cost, or more than cost. Benes agreed to pay cost because of McQuilkin's instruction and the first payment consisted of a journal entry by McQuilkin which applied $17,727.64 owed to Benes by the corporation for funds previously advanced by Benes to the corporation (App. 93a). Before Ben Lewitt set foot in Benes' office Benes made additional cash payments of approximately $53,000.00 (App. 93a). In spite of these facts, Ben Lewitt testified that Benes gave him an evasive answer when he, Lewitt, asked Benes if he intended to pay for the house. Lewitt could not remember and his notes did not show exactly how he phrased his alleged question, but he testified that the *import* of his question was whether Benes intended to pay for the house during construction. He did not ask Benes whether or not Benes intended to have the house for himself from the beginning. In light of Lewitt's testimony that he received an evasive answer to his alleged question, Lewitt was asked if he pursued the matter by so much as an additional question. His answer was that he did not pursue the matter because he did not want to "browbeat" Benes (App. 49a, 50a, 51a).

The chronology of Sullivan's phone call to McQuilkin; McQuilkin's call to Benes and Sullivan's first statement to Benes support completely Benes' contention that he had every reason to and did believe that Sullivan knew all about the house, the allocation of costs and the intended filing of amended returns. The Tax Court makes no comment about the chronology of the phone calls and Sullivan's visit and comments and concludes, in the face

of these facts, that Benes concealed information from Sullivan.

Frank Russell, one of Benes' superintendents, testified that he had *assumed* that the house was being built for Benes and that he asked Benes (when the house was just a shell and long before this problem arose) when he was going to move in. Russell testified that Benes said, " * * * when we get the thing built, we will sell it" (App. 41a). The Tax Court ignored Russell's testimony completely; ignored the fact that the quoted statement was made ante litem motem and ignored the fact *that respondent's special agent, Mr. Krock, had interviewed Frank Russell some five months prior to the trial of the case* and ignored the fact that respondent decided not to call Frank Russell.

The Tax Court notes the legend appearing on the drawings of the architect, Schwerzler, but makes no comment about the fact that Schwerzler testified that the legend was simply his assumption (App. 39a); that he had previously been questioned by Mr. Krock and Mr. Lewitt and that he had told them that it represented only his assumption. Neither does the Tax Court note that respondent did not call Schwerzler.

The Tax Court does not mention John C. Jones by name, but refers to him as "one of his (Benes') employees." The Court does not note that Jones was mistaken by almost two years in his recollection of the time of his employment; nor does the Court note that Jones' own testimony indicates that the alleged conversation, if it did take place, took place when the house was practically complete and not before construction was started. In fact the Tax Court gratuitously attempted to overcome the material discrepancy between the date of Jones' employment and his testimony that the alleged discussion took place before construction.

There is a basic difficulty with respondent's position. In the last analysis respondent contends that from the very beginning Benes intended to have his corporation build a house for him; that from the very beginning he intended not to pay for the house; that from the very beginning he concocted a clever mechanical method of recording designed to conceal his intentions; and that after having successfully fooled revenue agents (with no more construction work necessary) Benes confessed.

The Purpose of Injecting the Salary Problem

There can be no question that Benes reported all salaries received in all the years under review. The fact is that the respondent determined that there was an overstatement of salary income for the fiscal year ended May 31, 1950. In light of this fact and in light of the fact that Benes's individual tax bracket in years following 1947 (before any adjustments) was higher than his individual tax bracket in 1947 it is clear that neither the respondent nor the Tax Court was interested in the dollars and cents consequences of the constructive receipt theory.

What clearly was the purpose in the mind of the respondent and what was supported by the Tax Court was a "hedge against the possibility that the credible evidence would be insufficient to sustain a finding of fraud and that it would be necessary then to lift the bar of the Statute of Limitations" by applying the doctrine of constructive receipt with respect to salaries. In this way, the respondent hoped to avoid the burden of proving by the preponderance of evidence that Benes intended from the beginning to have the house for himself and that from the beginning he never intended to pay for it. In this way the respondent intended to shift the burden to Benes; to have respondent's

determination that there was an *ab initio* intention to acquire an *ab initio* intent not to pay to be presumptively correct and to face Benes with an almost insuperable burden of proving a negative; of proving, that he did not intend to have the house for himself from the beginning and that he did not intend not to pay.

The doctrine of constructive receipt was conceived by the Treasury Department to prevent a taxpayer from choosing (with an eye to tax consequences only) the year in which to report income by the simple process of electing when to reduce income to actual possession. The doctrine is an application of the rule that substance governs over form. Thus the ultimate question, is whether the deferment of payment is a mere subterfuge and sham for the purpose of enabling the taxpayer to postpone his income tax to another year and also to enable him to shift his income to a year in which the tax bracket was lower. The Tax Court in referring to the Commissioner's regulations neglected to complete the regulation. The regulation (applicable in this case) is Regulation 111, sec. 29.42-2 and the omitted portion provides, " * * * To constitute constructive receipt the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at anytime and its receipt brought within his own control and disposition."

First, it is true that at the first meeting of directors a resolution provided for the payment of an annual salary of $12,000 plus an escalator clause providing for a year-end bonus based on a percentage of profits. However, there is nothing in the record to support the Tax Court's conclusion that payment was required on a monthly, weekly

or quarterly basis. Neither is there anything in the record to support the Tax Court's conclusion that Benes was credited with $1,000.00 a month or that $1,000.00 a month was set aside for him. Because the corporation deducted $30,984 as salary expense for the fiscal year ended May 31, 1948, the Tax Court concludes that the corporation credited Benes with a basic salary of $1,000.00 each month. The conclusion is erroneous and the record does not support the conclusion. The amount deducted by the corporation represents simply the sum of the amounts actually paid Benes during the fiscal year plus a year-end accrual of the balance due under the resolution. The deduction claimed by the corporation does not mean that there was a monthly crediting to or setting aside for Benes.

The Tax Court refers to the case of *James J. Cooney,* 18 TC 883, and thus it is clear that the Tax Court is really saying that even if no amount was actually credited to Benes' account on a monthly basis, that because Benes controlled the corporation and alone wrote checks and that because the corporate cash balance as of May 31, 1947 was in the upper forty thousand dollars there was a "constructive payment" of monthly amounts of $1,000.00 for each of the first seven months of the fiscal year ended May 31, 1948.

The implication is, of course, that the failure to pay was dictated by Benes for the purpose of enabling Benes to postpone taxation and to shift income to lower bracket years. First, the correct cash balance as of May 31, 1947 is $47,361.32 and not $49,876.32 as found by the Tax Court. (The correct balance is shown in the opening balance sheet items in Schedule L for the fiscal year ended May 31, 1948.)

Second, the Tax Court failed to note that on May 31, 1947 there were current liabilities to accounts payable

sub-contractors in the amount of $34,119.92 and that there was a current income tax liability of $15,925.42 which was paid on August 17, 1947. (The payment is receipted on the face of the original return filed.) Thus, on May 31, 1947 the current, existing, and pressing liabilities to the Government and sub-contractors exceeded available cash. This does not include current requirements for salaries to office help, engineers, estimators; for rent and many other recurring overhead items. That cash was tight is evidenced by a cash balance at the end of May 31, 1948 of $1,900.24. Is not the fact that the corporation owed Benes $18,837.19 as of May 31, 1947 an indication that cash was tight and that it needed funds to operate currently. No payment was made to Benes to reduce the corporate indebtedness to him. Is it not crystal clear that the reasonable, necessary cash requirements for expenses (other than Benes' salary) exceeded cash availability and that this cash deficit was a substantial limitation as to time of payment of Benes' salary?

Furthermore, respondent, in his own memorandum, GCM 15565, CB Dec. 1935, p. 105 placed an additional limitation on the applicability of the constructive receipt doctrine. In that memorandum appellee states, " • • • There can be no constructive receipt of that which can be acquired or reduced to possession only by the surrender of valuable rights." Is it not true that Benes had the right to demand and get repayment of his loan to the corporation? Is it not also true that the Tax Court's finding of constructive receipt would deprive Benes of that right?

It is submitted that the Tax Court's conclusion is not only erroneous, but that it reflects an uneasiness and doubt about its own conclusion that there existed a fraudulent intent to evade tax on the part of Benes. If the Tax Court was as sure as its decision indicates, there would be no

necessity for the "hedge" apparent in the reference to a constructive receipt of salary.

Reasons for Granting the Writ

1. Where, as in the instant case, the problem involves the determination of an individual's intent, it is particularly important to examine, to consider and to base a conclusion on a consideration of ALL the evidence. It is submitted that the Tax Court's failure to comment in so many instances where salient, material and relevant facts had a direct bearing on the question of intent strongly indicates that the Tax Court did not consider the totality of the evidence in arriving at a decision but carefully selected and discussed only those bits of evidence which would support a preconceived notion of petitioners guilt.

2. In the criminal case which preceded the civil case here under review, the Court of Appeals for the Sixth Circuit noted that the Government had presented its case in meticulous detail and yet this Court in a decision rendered on March 21, 1960 said, "We do not agree with appellee's argument that the evidence of appellant's guilt was so overwhelming that the errors in the Court's charge should be disregarded or treated as inconsequential or harmless." The prejudicial error in the criminal case was reflected in the Court's charge; the prejudicial error in the civil case is reflected in the careful selection of isolated bits of evidence tending to support a preconceived notion of guilt and the careful discard of evidence tending to support petitioners' contentions. In spite of the fact that Sullivan's lie and Seidehammel's lie was not part of the record in the crim-

inal case, the Court of Appeals for the Sixth Circuit found no overwhelming evidence of guilt. In spite of the fact that Sullivan's lie and Seidehammel's lie was part of the record in the civil case, the Tax Court's opinion (affirmed by the Court of Appeals without opinion) finds an overwhelming evidence of guilt.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

(Order)

No. 16,227

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

ELMER J. BENES and FRANCES M. BENES,
E. J. BENES & COMPANY, INC.,

Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BEFORE:

WEICK, *Chief Judge,* CELEBREZZE, *Circuit Judge,* and CECIL, *Senior Circuit Judge.*

The above cause coming on to be heard on the briefs, record, and arguments of the parties, and the Court being duly advised:

Now, therefore, it is ORDERED, ADJUDGED and DECREED that the decision of the Tax Court be and is hereby affirmed for the reasons set forth in the opinion of Judge Pierce, reported in 42 T.C. 358.

Entered by order of the Court.

CARL W. REUSS
Clerk

(Filed Jan. 10, 1966.)